
# ROMANIA: EU funds help to weather the storm

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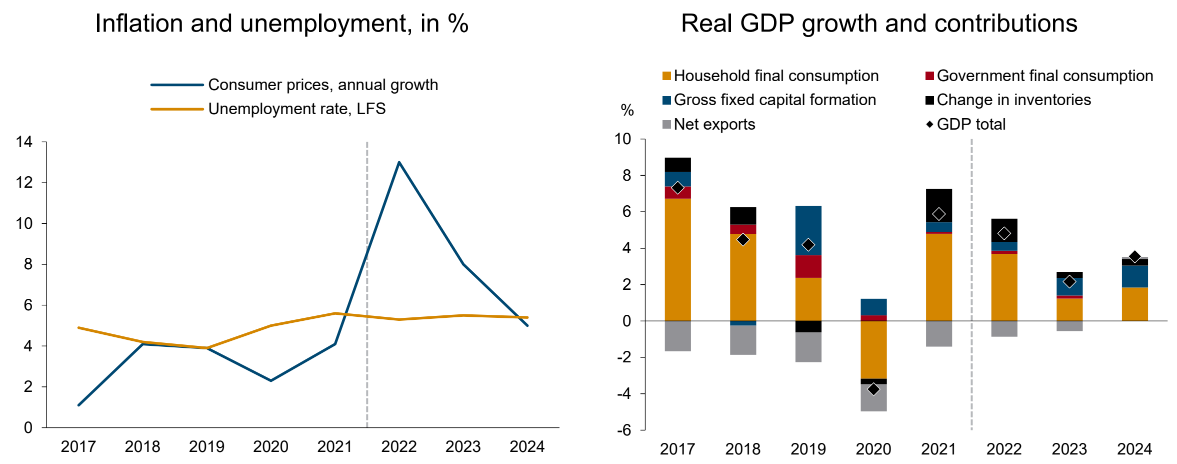
**Economic growth in Romania was among the most rapid in the EU in 2022, driven by household consumption and accumulation of inventories. However, future prospects are overshadowed by declining real wages and tightening fiscal policy. Still, with 2.2% growth in 2023, Romania will grow faster than most regional peers. The inflow of foreign direct investment (FDI) and EU funds will strengthen Romania's chances of balancing the fiscal and current account deficits and will maintain its ability to invest. The country's relatively modest dependence on energy imports from Russia also limits its vulnerability.**

**Figure 6.17 / Romania: Main macroeconomic indicators**




Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**Romania experienced rapid economic growth in Q2 2022 of 5.3% year on year, or 2.1% against Q1 2022 – the second fastest in the EU, after the Netherlands.** Household consumption and change in inventories made the largest positive contribution to growth. Gross fixed capital formation's contribution was modest, while that of net exports was very negative. Drivers of growth were retail trade, info-communications and other services that are still recovering from the COVID-19-related recession. But agriculture and industrial production stagnated in Q2 2022, while residential construction fell, showing that the economy is losing steam.

**Employment rose in the first half year, almost entirely on account of hiring in the private sector.** Minimum wages in agriculture and construction were hiked to mitigate the labour shortage. But in the public sector, no hiring or wage adjustments have been allowed since July, which has placed a burden on employers and employees alike. The unemployment rate fell marginally, but remained at above 5%. Average gross nominal wages recorded double-digit annual growth without, however, keeping pace with inflation. Declining real wages will persist in the coming months, thus reducing consumption spending.

**The consumer price index (CPI) rose month by month in the first half of 2022, but stabilised at 15% in Q3.** As in most other European countries, energy and foodstuffs have been the main drivers. Inflation should start cooling in Q4, on the back of energy price caps and base effects. The National Bank of Romania's (BNR) monetary policy remains lax: the policy rate was increased to only 5.5% in August, with the argument that core inflation is much lower than the CPI and stability is provided by the exchange rate. The BNR is pursuing a policy of managed flotation, making interventions on the currency market when it considers it necessary to keep the exchange rate stable and contain inflation. The money market interest rate, more important than the policy rate, stood at 8-8.5% in September, similar to the 10-year government bond yields. Expensive financing of the fiscal deficit of about 6.5% of GDP is increasingly becoming a burden, although the debt-to-GDP ratio is still below 50%.

**The BNR estimates that the current rate of inflation would be not 15%, but 21% had the government not introduced corrective measures to protect the population.** Petrol prices have been kept under control through subsidies, but have not been capped. From November 2021, price caps were applied to gas and power bills for households, small businesses, hospitals, schools and public institutions – up to certain monthly consumption levels. Suppliers were compensated for the price difference, while producers' windfall profits were taxed. In a new scheme put in place in September 2022 and due to last for one year, the monthly consumption levels that benefit from the price caps have been reduced by 15%, putting an extra burden on consumers. It also stipulates a contribution tax to be paid to an energy transition fund by not only producers, but also traders in energy. The capping scheme is expected to cost about 0.8% of GDP and should be totally covered by the new levies.

**The potential shortage of natural gas could be a risk to the economy and the population during the winter.** In 2021, the country's dependence on oil imports stood at 69%, and for natural gas – 28%. Imports of gas from Russia doubled to 3.5bn $m^3$ last year, via intermediaries through TurkStream (as Romania has no direct contract with Gazprom). Domestic production was in decline until last year, although it should increase in the future. Exploitation of the first offshore gas field has started and will deliver 1bn $m^3$ in 2023. An onshore project of similar capacity is due to start in two years' time. Besides, cross-border inter-connections built in the last couple of years will allow a diversification of imports and will open transit routes for neighbouring countries. The connection to the Trans-Anatolian gas pipeline will be ready later this year, at which point imports from Azerbaijan could commence. Of the country's crude oil imports, only a third came from Russia in 2021, and several refineries have already managed to find other suppliers.

**The current account deficit saw a rapid deterioration in Q2, mainly due to energy imports and worsening terms of trade.** Exports also expanded, mainly of food and agricultural products. As an effect of the war in the neighbourhood, Romanian salt exports registered a significant increase, filling the gap left by Ukraine. Trade in services grew even faster than in goods. Computer services are a booming export sector, and transport services exports also expanded, due to trade routes diverted from Ukraine. The primary income balance deteriorated on account of outflows of investors' income, partly counterbalanced by reinvestments as FDI inflows. Net FDI in 2022 is expected to surpass last year's figure and provides an important support in financing the current account deficit, which will reach almost 10% of GDP. Beyond private capital inflows, external financing relies massively on EU funds.

**The timely inflow of EU funds is a major support to economic stability and growth.** The European Commission has given a positive assessment of Romania's first payment request under the Recovery and Resilience Facility (RRF) to the tune of EUR 2.6bn, of which EUR 1.8bn is in the form of grants and EUR 0.8bn in loans. This comes on top of EUR 3.7bn prefinancing that the country received late last year. These funds will be available for a series of investment projects mainly in the transport infrastructure and the health and education sectors. There will also be funds to hand to support private investment in selected sectors, regions, and small and medium-sized enterprises. The approval of the Commission comes in response to the request for payment that Romania submitted in June 2022, when it reported progress on the milestones and targets set as conditions. The milestones referred to the progress of reforms regarding sustainable transport, decarbonisation, road safety, the electricity market, the improvement of fiscal administration and the intensification of the fight against corruption, among others. A request for the next RRF tranche of EUR 3.2bn is to be submitted in October, provided Romania can report progress on another 24 milestones. The administrative and legislative capacity may not be in place to meet all the conditions, but some delay in disbursement would not be detrimental. To cover the needs of national co-financing, the government has applied for a loan of EUR 4bn from the European Investment Bank. Back in June, the bank transferred EUR 1.4bn to Romania under the Modernisation Fund scheme to finance strategic projects in the country's energy sector.

**There are uncertainties and risks associated with the fiscal policy.** Even before the COVID crisis, the government was under the EU excessive deficit procedure, owing to its lax fiscal policy. The government therefore has its eyes set on a deficit in 2022 of 6.5% of GDP, lower than last year. The chances appear good that the target will be reached, thanks to higher-than-planned revenues triggered by upbeat consumption in the first half year and tighter policy measures. Fiscal measures introduced on 1 July stipulate a reduction in budget expenditure of at least 10% over the remainder of the year, except for the purposes of investment, salaries, pensions and social assistance, with a net effect of about 0.5% of GDP. As for social measures, the debt service moratorium was extended and the lowest pensions have been topped up with a one-off payment. The future fiscal deficit depends on the government's ability to finance the energy price subsidies by taxing windfall profits and to control wage demands. The social democrats in the governing grand coalition would prefer to boost minimum wages and pensions, but the liberals (who have provided the current prime minister) are trying to keep expenditure under greater control. In May 2023, when the position of prime minister switches to the social democrats, fiscal policy may loosen.

**Growth will slow down in the second half of 2022 and beyond.** Declining real wages and the burden of energy prices will weigh heavily on the population, despite the price caps and other corrective measures. GDP may stagnate in Q1 2023, to be followed by a modest recovery. The negative effects of inflation on consumption will dominate, while investments may pick up, financed by EU funds. A slowdown in demand on the main foreign markets will depress the export sector. Putting the effects of these processes on GDP growth into numbers, the wiiw forecast is revised upwards for 2022 (by 1.3 percentage points, to 4.8%); downwards for 2023 (from 3.5% to 2.2%); and also downwards for 2024 (from 4.5% to 3.5%). Should energy prices stabilise, economic growth could pull off a welcome surprise. The current account and fiscal deficits will not cause problems, so long as the inflow of EU funds is assured.

## Table 6.17 / Romania: Selected economic indicators

| | 2019 | 2020 | 2021 1) | 2021 | 2022 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|
| | | | | January-June | | | Forecast | |
| Population, th pers., average | 19,372 | 19,265 | 19,120 | . | . | 19,000 | 18,900 | 18,800 |
| Gross domestic product, RON bn, nom. | 1,059.0 | 1,058.9 | 1,181.9 | 503.2 | 609.0 | 1,420 | 1,600 | 1,760 |
| annual change in % (real) | 4.2 | -3.7 | 5.9 | 7.9 | 5.8 | 4.8 | 2.2 | 3.5 |
| GDP/capita (EUR at PPP) | 21,670 | 21,500 | 23,530 | . | . | . | . | . |
| Consumption of households, RON bn, nom. | 655.8 | 637.3 | 726.1 | 309.3 | 378.2 | . | . | . |
| annual change in % (real) | 3.8 | -5.1 | 8.0 | 5.9 | 7.6 | 6.0 | 2.0 | 3.0 |
| Gross fixed capital form., RON bn, nom. | 239.4 | 252.5 | 285.0 | 110.7 | 136.7 | . | . | . |
| annual change in % (real) | 12.9 | 4.1 | 2.3 | 12.2 | 2.2 | 2.0 | 4.0 | 5.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | -2.3 | -9.2 | 7.1 | 16.1 | -0.9 | -2.0 | 1.0 | 4.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -3.8 | -15.4 | 16.9 | . | . | . | . | . |
| Construction industry 2) | | | | | | | | |
| annual change in % (real) | 27.6 | 15.9 | -0.6 | 5.9 | 4.4 | . | . | . |
| Employed persons, LFS, th, average 3) | 8,680 | 8,521 | 7,756 | 7,740 | 7,815 | 7,830 | 7,830 | 7,830 |
| annual change in % | -0.1 | -1.8 | 0.7 | 0.7 | 1.0 | 1.0 | 0.0 | 0.0 |
| Unemployed persons, LFS, th, average 3) | 353 | 452 | 459 | 457 | 467 | 440 | 460 | 450 |
| Unemployment rate, LFS, in %, average 3) | 3.9 | 5.0 | 5.6 | 5.6 | 5.7 | 5.3 | 5.5 | 5.4 |
| Reg. unemployment rate, in %, eop | 3.0 | 3.4 | 2.7 | 3.0 | 2.6 | . | . | . |
| Average monthly gross wages, RON 4)5) | 4,853 | 5,213 | 5,535 | 5,685 | 6,284 | 6,200 | 6,800 | 7,300 |
| annual change in % (real, gross) | 7.3 | 4.7 | 1.1 | 4.4 | -1.1 | -1.0 | 1.0 | 2.0 |
| Average monthly net wages, RON 5) | 2,986 | 3,217 | 3,416 | 3,484 | 3,871 | 3,800 | 4,100 | 4,400 |
| annual change in % (real, net) | 8.8 | 4.9 | 1.1 | 4.5 | -0.5 | -1.0 | 1.0 | 2.0 |
| Consumer prices (HICP), % p.a. | 3.9 | 2.3 | 4.1 | 2.7 | 10.3 | 13.0 | 8.0 | 5.0 |
| Producer prices in industry, % p.a. | 3.8 | 0.0 | 14.9 | 6.1 | 46.7 | 45.0 | 15.0 | 5.0 |
| General governm. budget, EU def., % of GDP | | | | | | | | |
| Revenues | 31.9 | 32.7 | 32.8 | . | . | 34.0 | 33.0 | 33.0 |
| Expenditures | 36.2 | 42.0 | 39.9 | . | . | 40.5 | 39.0 | 38.5 |
| Net lending (+) / net borrowing (-) | -4.3 | -9.3 | -7.1 | . | . | -6.5 | -6.0 | -5.5 |
| General gov. gross debt, EU def., % of GDP | 35.3 | 47.2 | 48.8 | . | . | 49.5 | 50.0 | 50.0 |
| Stock of loans of non-fin. private sector, % p.a. | 7.0 | 5.0 | 14.3 | 10.9 | 16.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 4.1 | 3.8 | 3.4 | 3.8 | 3.0 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 2.50 | 1.50 | 1.75 | 1.25 | 3.75 | 5.75 | 4.50 | 4.00 |
| Current account, EUR m | -10,906 | -10,893 | -16,723 | -7,197 | -16,279 | -26,400 | -27,900 | -27,200 |
| Current account, % of GDP | -4.9 | -5.0 | -7.0 | -7.0 | -13.2 | -9.2 | -8.6 | -7.7 |
| Exports of goods, BOP, EUR m | 63,056 | 57,532 | 70,170 | 34,049 | 41,793 | 84,200 | 90,100 | 97,300 |
| annual change in % | 2.0 | -8.8 | 22.0 | 28.8 | 22.7 | 20.0 | 7.0 | 8.0 |
| Imports of goods, BOP, EUR m | 80,900 | 76,476 | 93,324 | 44,306 | 56,214 | 116,700 | 127,200 | 136,100 |
| annual change in % | 4.9 | -5.5 | 22.0 | 25.5 | 26.9 | 25.0 | 9.0 | 7.0 |
| Exports of services, BOP, EUR m | 27,058 | 23,764 | 27,909 | 12,508 | 16,730 | 34,900 | 38,400 | 43,000 |
| annual change in % | 13.7 | -12.2 | 17.4 | 9.4 | 33.8 | 25.0 | 10.0 | 12.0 |
| Imports of services, BOP, EUR m | 18,408 | 14,321 | 18,343 | 8,242 | 11,078 | 23,800 | 26,700 | 29,900 |
| annual change in % | 19.3 | -22.2 | 28.1 | 17.6 | 34.4 | 30.0 | 12.0 | 12.0 |
| FDI liabilities, EUR m | 6,574 | 3,056 | 8,813 | 4,210 | 6,370 | 11,000 | . | . |
| FDI assets, EUR m | 1,721 | 112 | 1,508 | 588 | 1,994 | 3,000 | . | . |
| Gross reserves of CB excl. gold, EUR m | 32,927 | 37,379 | 40,475 | 36,831 | 42,033 | . | . | . |
| Gross external debt, EUR m | 109,783 | 126,750 | 136,585 | 128,903 | 137,225 | 145,000 | 155,000 | 170,000 |
| Gross external debt, % of GDP | 49.2 | 57.9 | 56.9 | 53.7 | 47.6 | 50.3 | 48.0 | 48.1 |
| Average exchange rate RON/EUR | 4.7453 | 4.8383 | 4.9215 | 4.9014 | 4.9457 | 4.93 | 4.95 | 4.98 |

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Including the employers' social security contribution. - 5) Half-year data refer to enterprises with 4 and more employees. - 6) One-week repo rate.

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